THE INHERENT INTERNATIONAL TAX REGIME AND ITS CONSTRAINTS ON AUSTRALIA'S SOVEREIGNTY

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I INTRODUCTION

On 1 November 2011 the Minister for Financial Services and Superannuation, the Honourable Bill Shorten MP, announced that Australia would be undertaking a reform of the 'transfer pricing rules in the income tax law and Australia's future tax treaties to bring them into line with international best practice, improving the integrity and efficiency of the tax system.'[1] Mr Shorten stated that the reason for the reform was that 'recent court decisions suggest our existing transfer pricing rules may be interpreted in a way that is out-of-kilter with international norms.'[2] Further, he stated that 'the Government has asked the Treasury to review how the transfer pricing rules can be improved, including but not limited to how to be more in line with international best practice.'[3] He urged all interested parties to participate in this consultation process. On 16 March 2012, an Exposure Draft and accompanying Explanatory Memorandum outlining the proposed amendments to implement the first stage of the transfer pricing reforms were released. Within the proposed changes is the explicit embedding of the use of the OECD's *Model Tax Convention on Income and on Capital*[4] and *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*[5] to help determine the arm's length price. Does this mean that Australia engages in an international tax regime?

It is well known that the announcement and subsequent proposed amendments are in response to the recent Full Federal Court decision of *FC of T v SNF (Australia) Pty Ltd*[6] and its interpretation of Australia's transfer pricing provisions. Arguably, however, broader insight into the Federal Government's current approach to international tax issues can be gleaned. In the broader context, some would suggest that Mr Shorten's Press Release is contrary to the view often espoused that Australia is not bound by any form of international tax rules and nor do *true* international tax rules exist. Whilst there are some academics who advocate the existence of an international tax regime, international tax experts, particularly those involved in the process of implementing tax laws within domestic jurisdictions, have traditionally adopted the premise that there is no such thing as international tax law. Rather, it is a common claim that it is domestic principles which deal with cross-border transactions. International tax lawyers argue that it is the domestic law, coupled with double tax treaties, which is applied to international tax issues, not a set of cohesive international tax rules. Taxing authorities also argue that their international tax law is founded in domestic legislation and supplemented by double tax treaties. However, in the 21st Century, the question needs to be asked as to whether this really is the case or whether countries (in this case, Australia) either explicitly or implicitly adhere to a coherent set of principles, norms, decision-making procedures and rules known collectively as an international tax regime. Further, if it is accepted that countries do adhere to such a regime, the question needs to be asked as to whether there is explicit or merely implicit acceptance, and how that regime is embedded in the domestic tax legislative and procedural processes. This article argues that the proposed reform of Australia's domestic transfer pricing rules, which

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[1] The Hon Bill Shorten MP, 'Robert Transfer Pricing Rules for Multinationals' (Press Release, NO. 145, 11 November 2011) < http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/145.htm&pageID=003&min=brs&Year=&DocType=>

[2] Ibid.

[3] Ibid.

[4] Organisation for Economic Cooperation and Development, 'Model Tax Convention on Income and on Capital' (2010).

[5] Organisation for Economic Cooperation and Development, 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (2010).

[6] *FC of T v SNF (Australia) Pty Ltd* 2011 ATC 20-265.

apply to cross border transactions, is an example of the Federal Government accepting that an international tax regime does exist and hence is a move towards a clear embedding of those principles in the domestic legislation.

The claim of this article, that Australia adheres to an international tax regime, necessarily assumes that such a regime exists. As such, this fundamental claim must be addressed and international literature suggests that there is a lack of consensus as to whether this is the case. At the one extreme, it is suggested that tax laws, even when involving issues of an international dimension, are a matter for domestic sovereigns, with globalisation and true internationalisation being resisted. For example, Cockfield argues that international tax reform is 'one of the last policy battlegrounds of globalization'[7] suggesting that 'like some unruly beast, international tax policy refuses to be tamed by traditional international law principles.'[8] Yet, there are others who fervently argue that 'international tax' is part of international law,[9] with sovereignty constrained by the generally accepted elements of the regime so defined. These two examples are the extremes of academic debate, with others adopting a more cautious approach to any claims of international consensus. Adding to the complexities of any common international consensus is the difficulty of how particular authors define the body of principles or laws that they are attempting to group under the umbrella of international tax, a point not lost on others writing on this topic.[10]

As stated, the purpose of this article is to argue that the Australian Federal Government inherently accepts the existence of an international tax regime and adopts both the international tax policy and practice aspects embodied in that regime through its domestic rules and double tax treaties. It is argued that while the enactment of domestic principles suggests that jurisdictions like Australia are acting unilaterally in deciding their cross-border taxing rights, jurisdictions do not in fact act unilaterally but rather implicitly participate in what can be described as an international tax regime. In practice, the result is likely to be much more nuanced than academics may suggest, with jurisdictions attempting to balance what they perceive as constraints on their sovereignty imposed by international tax principles and norms, decision-making procedures and rules, with their domestic rights to legislate as they see fit. As such, this article, rather than suggesting that there is a body of international tax law, attempts to demonstrate that there is a middle ground which has been traditionally implicitly accepted by Australia but is beginning to be explicitly stated; that of an 'international tax regime' (as opposed to 'international tax law') which exists and has developed organically over the decades. It then attempts to explain how this implicit acceptance is embedded into the domestic decision-making processes.

II AN INTERNATIONAL TAX REGIME DEFINED

Literature dealing with international tax policy and practice generally falls into one of three categories: a study of domestic laws relating to cross border tax transactions (for example, Australia's CFC or transfer pricing regime); comparative policy or practice analysis using various jurisdictions as case studies (for example, territorial versus worldwide taxation using the US and Japan as examples of the two systems); or a study of the various world organisations and their policy approaches to international tax issues (for example, the OECD approach to, and work on, tax havens or the competition versus harmonisation debate). Literature arguing for an international tax regime, or common approach to cross border transactions, usually advocates for an international tax organisation as the appropriate forum for developing and administering such rules rather than suggest that implicit rules already exist.[11] However, in addition to this traditional literature, and despite its

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[7] Arthur Cockfield, 'International Tax Competition: The Last Battleground of Globalisation' (2011) 63(12) *Tax Notes International 867, 870.*
[8] Ibid.
[9] Reuven Avi-Yonah has been the strongest proponent of this view. See, for example, Reuven Avi-Yonah 'International Tax as International Law' (2004) 57 *Tax Law Review* 483.
[10] See for example Diane Ring 'International Tax Relations: Theory and Implications' (2007) 60 *Tax Law Review* 83, 115, who points out that clarification of terminology is crucial with tax practitioners, scholars, and government officials speaking of the 'international tax system' or 'international tax regime' by which they have in mind a wide assortment of common rules and problems as well as interactions among nations.
[11] See for example, Adrian Sawyer 'Is an International Tax Organisation an Appropriate Forum for Administering Binding Rules and APAs?' (2004) 21(1) *eJournal of Tax Research* 8 and Yariv Brauner 'An International Tax Regime in Crystallization' (2003) 56 *Tax Law Review* 259.

detractors,[12] there is a small body of work, lead by prominent international tax academic Avi-Yonah, which argues that a coherent international tax regime exists.[13] This literature, rather than suggest that countries are free to adopt any tax rules they choose, argues that jurisdictions are obliged to operate within the bounds of an existing international tax regime. The reasoning is not dependent on an international body as the ideal forum for implementing an international tax regime. Rather, it is grounded in the more pragmatic acceptance that such a body does not exist, with various bodies, in particular the OECD merely having influence over the policies contained within the international tax regime. Consistent with the views of Avi-Yonah and others, despite the lack of a single body overseeing an international tax regime and without the formal existence of such a body, it can be argued that, through the process of implicit acceptance, countries such as Australia already consider themselves bound, and therefore restricted by, certain higher level international tax principles.

The international tax regime which is discussed below and argued to exist needs to be distinguished from genuine international tax *laws*. A tax which applies at a supra-jurisdictional level does not exist and, as such, international tax laws in the strict sense are clearly not in existence. However, arguably an international tax regime which is much broader and takes on a different definition when determined utilising international relations theory, is very real. No doubt, there is scepticism in the international tax community as to the existence of an 'international tax regime', however, this may be the product of the equivocal meaning attributed to the word 'regime'. As such, it is necessary to explore what is meant by a regime. In some cases, when discussed in the context of international law generally, it seems to be no more than a euphemism for 'law'. Actual tax *laws* are an illustration of this labelling affect, with examples including the 'transfer pricing regime', the thin capitalisation regime' and the 'CFC regime' all referring to specific provisions within domestic legislation rather than the broader notion of a regime. A 'regime' is much broader than this.

Within the field of international relations, a regime takes on a specific meaning beyond that attributed to it by tax specialists or even non-professionals. Krasner, one of the pioneers of regime theory, offers an authoritative definition and describes regimes 'as sets of implicit or explicit principles, norms, rules, and decision-making procedures which actors' expectations converge in a given area of international relations.'[14] He expands on this definition describing principles as 'beliefs of fact, causation, and rectitude,'[15] whilst he describes norms as standards of behaviour defined in terms of 'rights and obligations.'[16] Further, 'rules are specific prescriptions or proscriptions for action'[17] and 'decision-making procedures are prevailing practices for making and implementing collective choice.'[18]

Each of Krasner's subcategories within a regime (principles, norms, rules and decision-making procedures) can be demonstrated to exist within current international tax policy and practice. Broadly, there are four sources of tax rules dealing with cross border transactions that meet this definition. First is the purely unilateral action of a jurisdiction pursuant to norms and rules which it is reasonably expected that other jurisdictions will also adopt despite there being no formal agreement or verification. Second, there are the bilateral agreements known as Double Tax Treaties which by and large follow internationally accepted norms and rules despite minor regional differences. Third, there are multilateral agreements which go to either the substantive internationally accepted principles or internationally adopted decision-making procedural practices. Fourth, there is the dominant international tax body, being the OECD (although the work on the UN in relation to developing countries should not be discounted), which also prescribes principles, norms and rules that are then adopted by domestic jurisdictions.

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[12] Reuven Avi-Yonah, *International tax as International Law: An Analysis of the International Tax Regime* (Cambridge University Press, 2007) and Reuven Avi-Yonah, 'Tax Competition, Tax Arbitrage, and the International tax Regime' (Working Paper 0709, Oxford University Centre for Business Taxation, 2007). Avi-Yonah lists Michael Gratz, David Rosenbloom, Julie Roin and Mitchell Kane as prominent tax authorities who advocate the view that there is no international tax regime.
[13] Reuven Avi-Yonah, 'International Tax as International Law' (2004) 57 *Tax Law Review* 483, 501. Avi-Yonah lists Hugh Ault, Yariv Brauner, Paul McDaniel, Diane Ring and Richard Vann as prominent tax academics who have supported his views.
[14] Stephen Krasner (ed), *International Regimes* (Cornell University Press, 1983) 2.
[15] Ibid 2.
[16] Ibid.
[17] Ibid.
[18] Ibid.

An international tax regime, using Krasner's definition, does not require a decree of that regime at a supra-jurisdictional level, for example by a body such as the OECD. Rather, implicit acceptance and adoption is sufficient. At a broad definitional level, a regime as defined by Krasner need be neither binding nor documented for there to be a convergence of expectations in a given area. As such, it can simply be the understanding by authorities of the principles to be complied with. A regime is not necessarily readily observable in the form of a multilateral agreement or written instrument of universal consent. Rather, it might simply operate as a practical restriction on the theory of unlimited sovereign power with the consequence that the Australian Federal Government is bound by the confines of the international tax regime. Obviously, however, defining a regime and stating that an international regime exists does not provide substance and content to that regime. With this in mind it is possible to expand on what may be considered the components or elements of the international tax regime.

III THE COMPONENTS TO THE INTERNATIONAL TAX REGIME

The components of the international tax regime are arguably grounded in both internationally accepted tax policy as well as internationally accepted tax principles, which are revealed upon considering the various elements of any domestic tax regime. As Avi-Yonah states 'to the extent that customary international tax law exists, this suggests that it is a mistake to deny the existence of an international tax system or regime. ... [w]e should not pretend that there are no binding, widely accepted international norms that we should flout only when significant national interests are at stake.'[19] If, as Avi-Yonah does, we accept that such a regime exists, it is necessary to explore the core components of that regime. The components are found within four key sources which were outlined above: the purely unilateral action of a jurisdiction pursuant to principles, norms, rules and decision-making procedures; the general consensus of broad principles contained within Double Tax Treaties; the multilateral agreements which go to either the substantive internationally accepted principles or internationally adopted procedural practices; and the works of bodies like the OECD. The substantive components of the international tax regime are located within each of these four key sources. This part of the article considers those various components to the international tax regime and outlines the elements which are arguably both internationally accepted tax policy as well as internationally accepted tax practice.

A *Internationally Accepted Policy*

At a domestic level, international tax policy is a matter for governments according to their social and economic imperatives. However, when formulating social and economic policy it may be argued that governments do adhere to, and in turn are restricted by, internationally accepted tax principles based on broader policy considerations. This is especially evident in the current economic climate with jurisdictions attempting to keep pace with global trends, including the increasing techniques and means of undertaking international transactions as well as the volume of those transactions.[20] Internationally accepted tax policy is based in both traditional concepts as well as current globalisation challenges.

Primarily, it is internationally accepted tax policy that there should be single taxation without the avoidance of tax. The thousands of double tax treaties which have been entered into around the world evidence this. The two primary goals of double tax treaties are first, the avoidance of double taxation, to remove any barrier to cross-border trade as well as the movement of capital and people between countries, and second, to prevent fiscal evasion, which has the potential to reduce a country's tax base. However, countries generally adopt these principles as a matter of course in their domestic legislation. Consequently, jurisdictions generally adopt the broad proposition that income should be fully taxed once and only once using the basic criteria of efficiency, equity and administrability.[21] A jurisdiction will aim to meet these objectives through a policy of national wealth maximization (getting its fair share of tax), tax equity (equal taxes on taxpayers will equal income) and economic efficiency (ensuring international competitiveness).[22]

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[19] See Avi Yonah above, n 9, 501. See also, Avi Yonah, 'An Analysis of the International Tax Regime', above n 12.
[20] Diane Ring 'International Tax Relations: Theory and Implications' (2007) 60 *Tax Law Review* 83, 83.
[21] Ibid, 87.
[22] Kevin Holmes, *International Tax Policy and Double Tax Treaties* (IFBD, 2007), Chapter 1.

In addition to these more pragmatic criteria, there are various economic neutrality benchmarks which aim to maximise economic benefits and minimise economic costs globally. The commonly used economic neutrality benchmarks, such as capital export neutrality (CEN), capital import neutrality (CIN), capital ownership neutrality (CON), national ownership neutrality (NON) and national neutrality (NN) are often debated and generally in conflict with each other. The relative merits of the separate benchmarks have been a matter of debate amongst economists since Musgrave's original 1963[23] work in the area. However, these benchmarks normally address international tax policy from a world-wide efficiency viewpoint where ideally the original benchmarks of capital export neutrality, capital ownership neutrality and capital import neutrality are all met. However, as Ring explains, 'this theoretical starting point seems quite distant from real world behaviour of nations, given the potential conflict between worldwide efficiency and national interests.'[24] In practice, achieving any of the individual benchmarks is difficult while achieving all would appear impossible and from a pragmatic perspective, jurisdictions are not focusing on economic benchmark theories, or worldwide harmonisation, but rather are increasingly focusing on competitiveness as the predominant principle.[25] This competiveness, driven by a broad range of imperatives, not predominantly by the raising of tax revenue but rather often by political and broader economic motivation, is then bound to the confines of internationally accepted tax policy. That is, 'countries need to participate in a shared vision, at least to some degree',[26] particularly to ensure any 'race to the bottom' of corporate tax rates is halted and tax havens are stamped out.

As a result of the conflict between these pragmatic imperatives and theoretical objectives, there will always be tension between the various stakeholders in the international tax regime. It then becomes a question for sovereigns as to the constraints they believe are placed on them being weighed against domestic policy.

B *Internationally Accepted Principles*

Implementation of internationally accepted tax policy, whatever a jurisdiction interprets that to be, requires broad international tax principles. Fundamental to the international tax regime are the principles relating to jurisdiction to tax, that is, residence and source, both of which are accepted as the basis for a jurisdiction to have taxing rights over income. The corollary is that countries do not attempt to tax income which is earned by a foreign resident and sourced outside the jurisdiction. This is not prevented by any specific law, but rather as Avi-Yonah suggests, has come about via customary international law.[27] It is through these two basic principles that the policy of fully taxing income once and only once using the basic criteria of efficiency, equity and administrability is achieved.

Residence and source principles are the normative basis for jurisdiction to tax within the international tax regime. This is not to say that the interpretation of these principles at a domestic level need be the same for all jurisdictions. Any differences in the implementation of residence and source rules at a domestic level do not detract from the fact that they are internationally accepted principles. Proponents against this proposition may argue otherwise, citing the United States as an example which falls outside the generally accepted adoption of the residence principle. However, the underlying jurisdictional basis for taxing can be more closely associated with nationality where there is the adoption of residence for almost all jurisdictions and the expansion to citizenship for the United States. This is simply the domestic implementation of the international tax principle.[28] The rules relating to residence of corporations also embrace internationally accepted principles, with the rules generally based on both a formal approach (place of incorporation or registration) and an economic or commercial connection (place of management or business).

Domestic source rules, which provide the second basis for a jurisdiction to claim taxing rights over income, also make up part of the international tax regime. Source is often seen as a difficult and arbitrary concept to apply, particularly when classifying income, but this does not detract from the internationally

[23] Peggy Musgrave, *Taxation of Foreign Investment Income: An Economic Analysis* (Johns Hopkins Press,1963).
[24] Ring, above n 20, 88.
[25] For example, Canada has explicitly stated that policy competiveness is the predominant principle and overrides the three economic principles as possible guides to setting international tax policy.
[26] Ring, above n 20, 89.
[27] Avi-Yonah, above n 9, 498.
[28] Ibid, 484-485 for a discussion on nationality and its expansion to residence within the tax regime.

accepted principles which accept that there are two broad categories of income, being passive and active income, with passive income generally sourced in the location of the payor and active income sourced in the location of the activities. As Vann explains, 'active income is usually sourced by a place-of-taxpayer-activity test, while passive income (where the taxpayer often engages in no significant activity in deriving the income) is sourced by the place of activity of the person paying the income.'[29] Again, a domestic jurisdiction's adoption and enactment of specific source rules may vary from country to country, but the principle of source and the need for source rules is accepted as part of the international tax regime.

Avi-Yonah summarizes the two basic principles as follows:

> International income taxation involves two basic questions: (1) What is the appropriate level of taxation that should be levied on income from cross-border transactions? (2) How are the resulting revenues to be divided among taxing jurisdictions? The answer to the first question is the single tax principles: income from cross-border transactions should be subject to tax once. The appropriate rate of tax for purposes of the single tax principle is determined by the second principle of international taxation, the benefits principle. The benefits principle … assigns the primary right to tax active business income to source jurisdictions and the primary right to tax passive income to residence jurisdictions.[30]

Complementing these internationally accepted principles or norms giving rise to the right to tax are the integrity and anti-avoidance provisions which are also embodied in an international tax regime so defined. Most developed jurisdictions have such regimes embedded in their domestic legislation and DTAs, including general anti-avoidance rules, special tax haven provisions, transfer pricing rules, CFC legislation, offshore investment fund rules, anti-treaty shopping articles and thin capitalisation rules. For example, the controlled foreign corporation (CFC) concept, is a model which originated in the United States in 1962 but has since been embraced by nearly 30 jurisdictions around the world.[31]

The arm's length standard required where transfer pricing occurs is one of the preeminent examples of an element of the international tax regime. The arm's length price has been around for approximately 90 years, introduced in the 1920s by the League of Nations and formally adopted in 1933. The OECD has also been advocating the arm's length price for many decades releasing its original guidelines as to how to determine an arm's length price in the 1979 report on transfer pricing.[32] The arm's length principle is a model which remains unchallenged by jurisdictions with only the arm's length methodologies called into question despite the fact that it 'starts from the fiscal myth that every subsidiary and permanent establishment within a group is a separate entity which conducts trade under free-market conditions with other entities in the group'.[33] The current Australian response to transfer pricing issues is also the impetus for this article.

The prevention of double taxation is also accepted as part of the international tax regime with countries either providing an exemption or a credit for foreign tax paid by their residents. Complementing the residence and source rules is the generally accepted principle that residence yields to source where there is double taxation because of a clash of these two principles, with the residence country being responsible for relieving the double taxation.[34] This is done by jurisdictions whether or not they are obliged to do so through a double tax agreement, with relief normally contained within domestic legislation. Clearly, whether an exemption or credit model should be adopted is open to dispute with different jurisdictions adopting different approaches, often a combination of the two systems of relief, but it is not disputed that relief should be granted. As such, this broad principle of providing relief from double taxation is part of the international tax regime.

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[29] Richard Vann, 'International Aspects of Income Tax' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 2, 718, 734.
[30] Ayi-Yonah, above n 12, 8-9.
[31] Argentina, Australia, Brazil, China, Canada, Denmark, Estonia , Finland, France , Germany, Hungary, Iceland, Indonesia, Israel, Italy, Japan, Italy, Lithuania, Mexico, New Zealand, Norway, Portugal, South Africa, Spain, Sweden, Turkey, UK, US, Venezuela. See Brian J Arnold and Michael J McIntyre, *International Tax Primer* (Kluwer, 2002) 87-98.
[32] Organisation for Economic Cooperation and Development, 'Report of the OECD Committee on Fiscal Affairs on Transfer Pricing and Multinational Enterprises' (1979).
[33] Hubert Hamaekers 'Arm's Length – How Long?' in Paul Kirchhof, Moris Lechner, Arndt Raupach and Michael Rodi (eds), *International and Comparative Taxation: Essays in Honour of Klaus Vogel* (Kluwer, 2002) 29-39.
[34] Vann, above n 29, 721.

The components of the international tax regime, briefly and broadly discussed above, are all part of Australia's domestic legislation and tax treaty network. The next part of this article attempts to offer an explanation as to how these various components are embodied within this domestic tax law and tax treaty network. More importantly, it attempts to provide an explanation for the adoption by Australia of the constraints placed on it by accepting, whether implicitly or explicitly, an international tax regime.

IV AUSTRALIA'S ADOPTION OF AN INTERNATIONAL TAX REGIME

International influence over the substantive features of Australia's tax regime is generally not considered to exist except in so far as broader imperatives or those external to direct fiscal raising are relevant. For example, maintaining competitiveness with the corporate tax rate in a global economy or ensuring there is not an exodus of skilled workers because of high (perceived or real) personal tax rates are clearly considerations. Yet, in relation to international influence, the November Press Release referred to in the introduction to this article tells a different story. To recap, the following pertinent statements were made in that press release:

> The Assistant Treasurer Bill Shorten announced today the Government will reform the transfer pricing rules in the income tax law and Australia's future tax treaties to bring them into line with international best practice, improving the integrity and efficiency of the tax system.
>
> Modernised transfer pricing rules will reinforce the integrity of the corporate tax base and align our rules more closely to international standards.
>
> Last year, for example, the OECD substantially updated its Transfer Pricing Guidelines, which are used by governments and business alike. Further, recent court decisions suggest our existing transfer pricing rules may be interpreted in a way that is out-of-kilter with international norms.
>
> The Government has asked the Treasury to review how the transfer pricing rules can be improved, including but not limited to how they can be more in line with international best practice.
>
> These amendments will also clarify that the treaty rules are to be applied in a manner that promotes consistency with the OECD Guidelines.[35]

The wording of the November Press Release is telling in that it specifically refers to international *norms* (noting the plural) but omits to elaborate on what those norms are. Given the target audience of the Press Release, very little can be read into such a press release except that there is an inherent acceptance within the statements made that first, there are international norms, and second, there are numerous international norms, which Australia considers itself required to follow to ensure international best practice. This invites the question as to what these international norms are, what their sources are and why these norms (or, why should these norms) purport to act as a restraint on the freedom of Australia's legislature and judiciary. Furthermore, the reference to 'plural' norms suggests that Australia adopts a position that academics have debated, namely the existence of a whole and ascertainable international tax regime of norms, rules and decision-making processes with which Australia complies.

The general premise upon which tax laws are based is that when faced with a domestic tax problem, democratically elected governments such as Australia's, have unlimited legal powers to create binding rules through legislation. The basic assertion is that each separate and autonomous state enjoys the freedom to legislate on all its subjects and to the extent that it chooses. Again, in the case of Australia, Constitutional constraints are then placed on this freedom, as well as democratic constraints requiring the government to (theoretically) act in the interests of the people. The success or failure of domestic tax law is attributed to the competence of parliament and its advisors analysing its own jurisdiction and acting in the interests of their electors. Most importantly, these domestic rules do not generally have an international influence. However, where a tax problem is international, there may be overriding international considerations as a government's own tools to remedy the problem may prove insufficient. Ultimately, a government may have to turn to the 'international tax regime' to find a solution. In essence, as the November Press Release suggests, Australia is turning to what it considers to be international best practice through the work of the OECD on transfer pricing

[35] Shorten, above n 1.

thereby proactively electing to adopt and be constrained by what could be seen as part of the international tax regime.

The question is why is Australia now explicitly accepting that it is constrained by an international tax regime? Perhaps this can simply be explained by globalisation, as there is no doubt that globalisation over the last two decades 'has brought the diversity of income tax laws into sharp focus.'[36] More broadly, the global framework within which sovereign nations must operate has also changed significantly in recent decades.[37] As Bentley explains:

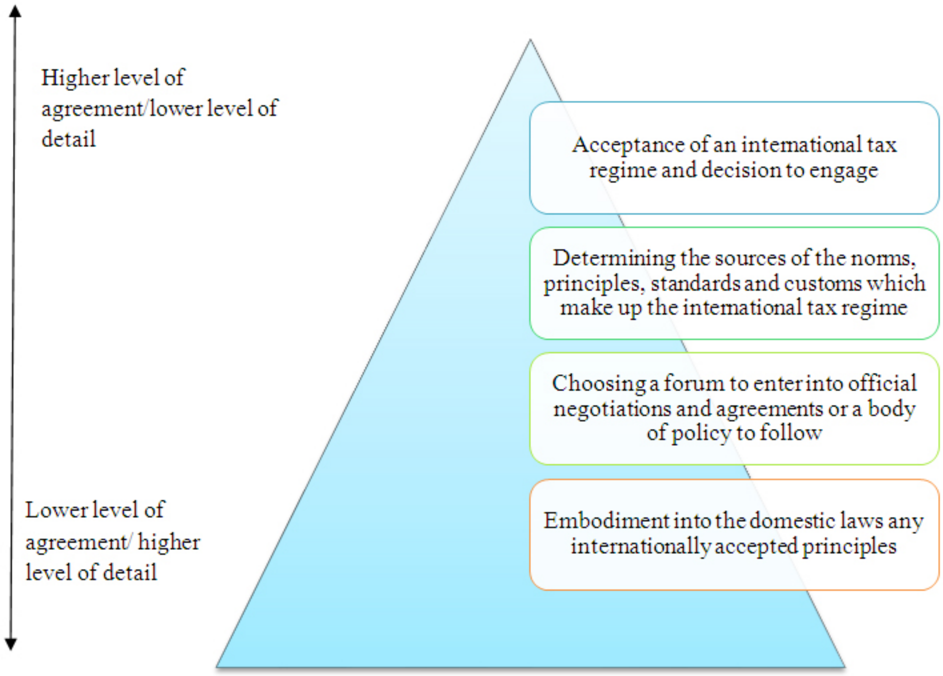
> Ultimate sovereignty supposedly rests in the nation state. Yet that sovereignty is increasingly limited by binding agreements at the supranational level. At all levels, the framework is determined in part by the formal legal and administrative authority vested in each component, whether an international organisation, a national government, a state or provincial government, a city or town council, or some other entity vested with civic authority. However, there is a further vital dimension to the operating framework. It is the voluntary and involuntary cooperation that provides an informal counterpoint to the exercise of formal legal and administrative authority.[38]

This statement suggests that the constraints principle flows one way towards domestic jurisdictions. However, the matter is more complex. Others argue that, rather than globalisation, with its accompanying international tax regime constraints, limiting sovereignty, it is sovereignty which limits the globalisation of international tax. It is often argued that 'sovereignty and competition for tax dollars has been an impediment to greater administrative cooperation'[39] on tax matters amongst nations. That is, sovereignty is seen as the constraining factor. From a substantive tax law perspective, 'sovereignty also has been an impediment to achieving greater coordination in income tax laws.'[40] As such, there is the potential conflict between the constraints of sovereignty versus the constraints of globalisation and the question becomes one of balance.

With the competing impediments of both sovereignty and globalisation in mind, whether a government, or in this specific case the Australian Federal Government, decides to engage in the international tax regime is arguably decided through a process of progression through various steps. Arguably, these steps are not articulated but rather inherent in the processes followed when the Federal Government is considering principles of Australian international tax law. This article attempts to explain the adoption of an international tax regime by suggesting that a process is followed in Australia which provides a four part progression through a decision-making model, ultimately determining the decision to engage in, and therefore be restricted by, what is likely to be seen as the 'international tax regime', containing both international tax policy and international tax principles described above. At each stage, and as the 'regime' becomes less about broad international tax policy and principles and more about the technical detail, the government may elect to opt out of the progression depending on the constraints it believes are placed on its sovereignty coupled with a decision on the relative importance of the conflicting imperatives.

[36] Lee Burns, 'Commentary' (1999) 53 *Tax Law Review* 39, 40.
[37] Duncan Bentley, 'International Constraints on National Tax Policy' (2003) 30 Tax Notes International 1127, 1127.
[38] Ibid 1128.
[39] Burns, above n 36, 41.
[40] Ibid 42.

The stages can be represented diagrammatically as a decision pyramid:



The transition through the steps cannot be described as seamless (especially the second and third steps) and as such are not afforded separate and autonomous discussion.

Before a jurisdiction can actively engage in an international tax regime, it must necessarily be accepted that one exists, arguably something that the Australian Federal Government has done as evidenced by the press release already discussed. The acceptance of an international tax regime then leads a sovereign to the first decision in the adoption process, whether to engage with other sovereigns (or even a broader category of stakeholders) in following broad international tax policy. It is within this context that Australia must make a decision as to whether to cooperate with the generally accepted norms of an international tax regime or whether a unilateral approach which ignores the global issues be adopted. This decision involves an assessment as to whether the benefits of following generally accepted principles outweigh the detriments. This will generally be answered by assessing the gains in tax revenue as well as other economic benefits from attracting capital imports as well as international perception against the forfeiture of a certain amount of autonomy and sovereignty. With each case, a different decision may be reached and, as Bentley explains, there are various 'barriers to common approaches to taxation, even within federal systems. Political independence, ideology, and a jealous guarding of sovereignty often can prove more influential than economic imperatives.'[41]

Consequently, the competing considerations as to whether to engage in the international tax regime need to be weighed against domestic considerations. At this stage, the influence of various stakeholders comes into play as taxing authorities are not the only participants in international tax debates – 'Tax professionals and taxpayers, especially multinational corporations, actively seek to understand, influence, and shape international tax law and policy.'[42] The result is that 'the international stage is now crowded with individuals, organisations, and different levels of government, each with their own agenda.'[43] For any jurisdictions 'acting unilaterally, in the absence of cooperation, the principal considerations ... are equitable tax treatment for its residents/citizens and its national economic interest. Such interests include the level and growth of national income, the distribution of such

[41] Bentley, above n 37, 1129.
[42] Ring, above n 20, 83.
[43] Bentley, above n 37, 1128.

income, and its balance of payments with the rest of the world.'[44] Conflicting with domestic sovereignty are the inevitable consequences of globalisation as 'globalisation requires, or perhaps forces, a high degree of consensus policy and appropriate mechanisms to cater for the innovations that it has spawned, such as in the internationalisation of the financial markets. Globalisation clearly brings pressure to bear on traditional tax principles.'[45]

It is at this stage that the Australian Federal Government must weigh the concerns about negotiating with other states, the possible impairment of democracy and most importantly, the forfeiture of the full ability to legislate domestically in the interests of Australian citizens. Yet, no doubt, Australia has made the decision to engage in the international tax regime and constraints are unavoidable if a jurisdiction wishes to participate in the global economy. First, there are international constraints on domestic tax policy, and while they 'tend not to be overt', they do 'set the framework for policy.'[46] However, 'moving outside that framework raises the risks of unintended and sometimes detrimental consequences that most democratic governments prefer not to take.'[47] Bentley also provides a second reason as to why Australia conforms to an international tax regime, stating that 'it is inevitable, therefore, that if Australia is to remain a player within the OECD in tax matters, that the Federal Government will largely conform its international tax policy approach to that of the OECD'.[48]

Where the Australian Federal Government decides to engage in the international tax regime it must locate the sources of agreement between sovereigns that make up that regime with those components taking a number of names including norms, principles, standards and customs. As discussed above, the broad norms, such as the single tax principle, attract the most in principle agreement but the least agreement as to means of enactment. On the other hand, specific norms, such as transfer pricing rules, are often very similar amongst sovereigns that accept them as valid solutions. It is particularly evident in Australia that there has been a voluntary acceptance of international norms, particularly in the areas of tax avoidance and fraud where the legislative and administrative processes adopted domestically are designed to protect the revenue base.[49] No doubt, determining these international norms, principles, standards and customs and deciding to adopt them, places impediments on domestic policy. The approach to solving global diversity issues in income tax has been very different to how other international trade matters are generally reconciled.[50] Traditionally the latter are dealt with from a global perspective whereas tax matters at best are dealt with bilaterally,[51] and occasionally multilaterally. Yet it must be recognised that 'international economic convergence places strains on domestic tax systems, which have their own rules specific to their particular policy imperatives. For international transactions, however, it is important that economic convergence produces tax rules that do not inhibit increased economic activity.'[52] As Vann explains, 'as the importance of the international dimension on income taxation has grown, an international consensus has emerged about the structure of the international income tax regime.'[53] This is evident within Australia's domestic legislation.

A government often makes a choice as to the forum officially to enter into an agreement on the international tax policy and practices to be followed, as well as the body of policy to follow. Since the 1960s, the almost exclusive forum for these negotiations and agreements has been the Organisation of Economic Cooperation and Development (OECD) due to its reputation and expertise in dealing with international tax problems. The OECD has led the way in treaty negotiations with its Model Tax Convention on Income and on Capital forming the basis for most of the thousands of tax treaties worldwide. As Vann explains, 'the major difference between international income tax law and the remainder of the income tax lies in the pervasive

[44] Peggy Musgrave, 'Sovereignty, Entitlement and Cooperation in International Taxation' (2001) 26 *Brooklyn Journal of International Law* 1335, 1338.
[45] Sawyer, above n 11, 15.
[46] Duncan Bentley, 'Influence from the Shadows: The OECD, The Shape of the Domestic Tax Policy and Lessons for Federal Systems' (2003) 13(1) *Revenue Law Journal* 128, 134.
[47] Ibid.
[48] Ibid 138.
[49] Ibid 132.
[50] Burns, above n 36, 41.
[51] Ibid.
[52] Bentley, above n 46, 130.
[53] Vann, above n 29, 721.

importance of treaties.'[54] Arguably, the success of the OECD is evidence of the number of jurisdictions which do accept the existence of a broad international tax regime and are prepared to engage in that regime. Australia is no exception to this. 'The success of the OECD Model as a basis for Australian and other countries' double tax agreements shows that there is much to be gained from policy convergence of this kind.'[55] Having said this, there are occasions when Australia also relies on the work of the UN. As Bain et al observe 'the extent to which Australia's treaties draw upon OECD or UN precedents reveals much about Australian negotiators' perceptions of Australia's interests and economic position vis-à-vis its treaty partners'.[56] Bain, et al examine 'the influence of the OECD and UN Models on Australia's treaty policy and consider why Australia might in some cases have followed one Model or the other or, in some instances, has followed neither'.[57] They conclude that 'a study of Australia's tax treaties indicates Australia's willingness to adopt different stances in negotiations with OECD and non-OECD members, often yielding taxing rights to development and transitional countries. … examples … may be seen as an affirmation of the important role of geo-political objectives in the negotiation of tax treaties'.[58] This reminds us of the broader competing imperatives beyond tax revenue raising as well as the rival constraints.

It is at this stage that we can start to consider the international tax regime as containing 'soft laws'. For example, as discussed earlier it is currently proposed that the OECD's *Model Tax Convention on Income and on Capital*[59] and *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*[60] be embedded into Australia's domestic legislation on transfer pricing. Further, the OECD can be regarded as a 'soft institution', with its approach of encouraging discussion and study.[61] As Cockfield explains, 'soft institutions are said to be more informal processes employed to achieve consensus by providing a forum for actors to negotiate non-binding rules, such as principles, instead of binding conventions'.[62] At this stage of the process, a sovereign is likely to have greater concern about yielding its power to international principles ultimately constraining itself by any such yielding. Australia considers itself a major 'player' in the development of OECD tax policy and is likely to maintain this approach to ensure its influence, thereby minimising what it views as the giving up of its sovereignty. Again, Cockfield elucidates this point: 'The preservation of tax sovereignty is likely a necessary prerequisite for the development of widely-accepted tax rules. The OECD process more closely resembles customary international law, which is perhaps best understood as a set of normative expectations developed through observation of the actions of states.'[63]

Starting with the general premise that there is a desire to preserve sovereignty, there is then a certain amount of yielding to the accepted international tax regime. Australian tax treaties are an example of this as they are generally negotiated starting from a model which closely resembles the OECD Model Tax Convention on Income and on Capital.[64] Although, as Bain et al explain, 'they are quite flexible, however, and appear willing to accommodate partners' interests in respect of terminology and some substantive measures where adjustments are needed to accommodate the partners' legal system, domestic tax rules, or particular treaty concerns'.[65] The influence of the OECD Model is clear with even the structure followed in nearly all existing tax treaties.[66] As Vann observes 'on the basis of these models and its own particular policies, each country generally develops its own model that serves as a starting point in negotiations to conclude a tax treaty with another country'.[67] Consequently, 'tax treaties continue to serve important purposes, and it is a mark of the success of the 20th century tax treaty movement, and of the OECD Model in particular, that there now exists an

[54] Ibid 719.
[55] Bentley, above n 46, 138.
[56] Kathrin Bain, Richard Krever and Anthony van der Westhuyen 'The Influence of Alternative Model Tax Treaties on Australian Treaties' (2011) 26 (1) *Australian Tax Forum* 31, 32.
[57] Ibid 33.
[58] Ibid 49.
[59] Organisation for Economic Cooperation and Development, above n 4.
[60] Organisation for Economic Cooperation and Development, above n 5.
[61] Arthur Cockfield, 'The Rise of the OECD as Informal 'World Tax Organisation' Through National Responses to E-Commerce Tax Challenges' (2006) Spring *Yale Law Journal* 137, 167.
[62] Ibid.
[63] Ibid 168.
[64] Bain et al, above n 56, 32.
[65] Ibid.
[66] Vann, above n 29, 724.
[67] Ibid.

international tax regime that is almost universally accepted'.[68] Further, 'in a very general sense, entering into tax treaties acts as a signal that a country is willing to adopt the international norms'.[69]

What can we take from Australia's adoption of the OECD Model and approach to international tax issues? As Cockfield explains:

> The OECD approach is consistent with emerging views in international relations theory that "government networks" (e.g., relatively informal arrangements among government officials in the same agencies) may be best at addressing global challenges. Informally coordinated and networked action by governments, it is thought, may lead to a new form of international law and policy-making that addresses these challenges without imposing undue restrictions on national sovereignty. Similarly, the use of non-binding institutions promotes the interests of the OECD members by reducing tax obstacles to international trade and investment (thus encouraging national economic growth) while protecting tax sovereignty to the greatest extent possible.[70]
>
> As is the case in other areas of customary international law, peer pressure and the need to promote business certainty (again to promote national economic welfare) encourages the OECD member states to follow the consensus views once they have been adopted into the OECD model tax treaty. In contrast, conventional international law typically involves the use of treaties that, once entered into, create continuing obligations, unlike the OECD model tax treaty. Through the use of informal mechanisms, the OECD mediates and manages the expectations of its member states in an attempt to generate politically acceptable (and hopefully effective) international tax policy.[71]

The final step in the process of engaging in an international tax regime is to embed that regime into domestic legislation or DTAs. It is at this stage, with a high level of technical detail involved, that the most diversity is seen and 'national idiosyncrasy' is accepted as reasonable within the confines of what has been implicitly or explicitly accepted internationally.[72] Although, even at this level a sovereign will feel constrained by the international tax regime as it cannot be denied that 'in the development of a country's tax laws, the international dimension plays an increasingly important role that significantly restricts the rules that might be adopted if regard were had only to domestic considerations'.[73] Again, it is emphasised that 'the increasing role of international factors is mainly attributable to the globalization of the world economy'.[74]

Over the years, there have been attempts to design internationally accepted rules which can be adopted by domestic jurisdictions. For example, the 1996 Basic World Tax Code and Commentary[75] by Hussey and Lubick, sponsored by the Harvard University International Tax Program, is one such attempt to formulate a global legislative framework. However, it is recognised that even with a model code, differences would need to be recognised and alternative statutory choices would need to be provided to take into account jurisdictional 'policy and policy choices, legal culture and systems, economic, political, and social structures, and drafting styles'.[76] It is unlikely that international, or even multilateral, consensus would ever be reached as to what a domestic tax regime should look like. Diversity at the implementation level is not likely ever to be completely resolved, nor arguably is it always necessary and when it is required, DTAs serve that purpose. As Burns explains, 'Diversity in design of income tax laws has come about for a number of reasons. First, and most obviously, diversity reflects different legal frameworks and cultures'.[77] 'Secondly … diversity reflects historical factors'.[78] 'Third, diversity reflects the pursuit of different policy objectives, particularly the use of the tax system to encourage certain economic activities. Fourth, diversity reflects different stages in economic

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68 Alex Easson 'Do we Still Need Tax Treaties?' (Dec 2000) *Bulletin – Tax Treaty Monitor* 619, 625.
69 Vann, above n 29, 726.
70 Cockfield, above n 61, 167.
71 Ibid 168.
72 Bentley, above n 46, 138.
73 Vann, above n 29, 719.
74 Ibid.
75 Ward Hussey and Donald Lubick, 'Basic World Tax Code and Commentary' (1996) <http://www.taxhistory.org/www/bwtc.nsf/PDFs/basica.pdf/$file/basica.pdf >.
76 Richard Gordon 'Some Comments on the Basic World Tax Code and Commentary' (July 26, 1993) *Tax Notes International* 279.
77 Burns, above n 36, 39.
78 Ibid.

development.’[79] ‘Diversity of income tax laws always has had an impact on international transactions. Consequently, there has always been a need for a mechanism to limit the impact of diversity on such transactions and traditionally, this has been the role of bilateral tax treaties.’[80] However, as already pointed out, there are thousands of treaties worldwide which are remarkably similar in their design.

V THE WAY FORWARD

The complexities in engaging in an international tax regime for a jurisdiction like Australia are not easily unravelled. Perhaps in the future globalisation will lead to a truly international and official global tax authority. However, for the moment it seems that these conflicting constraints will remain. Nations are likely to maintain the view that their tax system is one which they ultimately have control over. It is a system which allows sovereigns to implement their domestic social and economic policy objectives which are of national interest. As such, ‘tax sovereignty concerns remain one of the prime drivers of international tax policy’.[81] Given this proposition, it is much more likely that we will continue to see the organic progression of the international tax regime with both implicit and explicit acceptance as Australia is currently doing with its transfer pricing regime. Globalisation has ultimately led to tax competition rather than cooperation.[82] Given this conclusion, the international tax regime that Australia accepts as being in existence will be seen as a barrier to domestic choice and ‘notwithstanding the pressures of globalisation, there appears to be little immediate prospect of any significant change to the strongly national approach to income tax design and administration’.[83]

To answer the question as to whether Australia should or does engage in an international tax regime, there seems little doubt that it should and it does. However, arguably it does so not out of a desire to adopt international principles necessarily by choice, but rather because of the necessary international constraints it feels compelled to accept. Sovereignty is seen as a constraint on the true globalisation of an international tax regime and globalisation is seen as a constraint on domestic sovereignty. Australia seems to accept that this is the case.

[79] Ibid.
[80] Ibid 40.
[81] Cockfield, above n 61, 180.
[82] Burns, above n 36, 42.
[83] Ibid.